



Center for Strategic & International Studies
Washington, DC

MEMORANDUM

To: Trade Deficit Review Commission

From: Sidney Weintraub, William E. Simon Chair in Political Economy

Subject: Statement for Commission for presentation on September 9, 1999
(Presented in my personal capacity)

I was asked to make brief comments on some micro consequences of the trade deficit on the U.S. economy. My remarks will concentrate on employment and wage effects of international trade.

You ought to know where I come from so that you can put my remarks into the context of your individual thinking. I am not sure which comes first, the trade (or current account) deficit or the capital surplus. In any event, wherever you draw the line, neither of these deficits could exist if it could not be financed. Capital has been flowing into the United States for a number of reasons: the vitality of the U.S. economy as compared with other industrial economies; the flexibility and depth of U.S. capital markets; and, for portfolio capital, the confidence that the funds can be withdrawn when demanded. If the capital inflows were cut off – for example, if the United States imposed capital controls – the current account deficit would also disappear. The welfare cost on the U.S. economy if we were not able to use foreign savings to finance U.S. investment would surely be quite severe. If the U.S. economy were to crash and a recession or depression ensue, the trade deficit would go down or disappear, but this is obviously not a desirable outcome. I do not envy the Commission its task of trying to analyze the trade deficit in isolation from other aspects of U.S. interaction with the world economy – if that is what you are being asked to do.

Employment

The U.S. economy is operating at full employment and this makes it evident that the large trade and current account deficits are having no meaningful depressing employment effect on the economy as a whole. This is what one would expect from an economy as large as that of the United States. Job creation is largely the result of the state

of the domestic macroeconomy. Job creation, as you all know, has been extremely robust in the United States in recent years.

This does not mean that workers in particular activities, or who are disadvantaged in the current U.S. economy, are not affected by trade. I used the word “trade” deliberately and not “deficit.” Even if our exports of goods and services exceeded our imports, i.e., if we had a trade or current account surplus, the employment in most of the sectors in which jobs are declining would not alter very much. If Boeing exported more wide-bodied aircraft or the foreign sales of information technology became even more robust than they are already, this would not help workers in the needle trade or steel production. It is not the external deficit that is causing job losses in these areas, but rather their lack of competitiveness or, if you wish to use the traditional economic term, the lack of U.S. comparative advantage. I do not wish to imply that comparative advantage is static, that noncompetitive sectors can never regain vigor, but this is not the same as pointing to a trade deficit as the villain in the picture.

Imports do lead to job losses in directly competing sectors. Growing exports do lead to job gains. In both cases, however, these are not the critical job-creation or job-destruction effects. Trade is not the heart of the matter with respect to employment in the economy as a whole. To repeat, this depends on the health of the domestic economy and policies to stimulate noninflationary growth.

Let me approach the job/trade issue from another angle. The United States has been gaining jobs in a number of sectors in which U.S. activities have been highly competitive, both on the world scene and domestically. The activities that most come to mind are in the technology area – such as information generation and computer software. Information technology employment grew by 2.4 percent a year in the 10 years 1989-1997, and the end of this growth is by no means in sight. By the same token, jobs are being lost in sectors in which the United States cannot compete without import protection. Clothing manufacture comes to mind. Protection saves some jobs, but at a high cost in resources.

The U.S. International Trade Commission in a recent study (“Economic Effects of Significant U.S. Import Restraints,” May 1999) concluded, based on a model for the year 1996, that if all protection that then existed were removed, this would have resulted in 135,000 job losses that year. Most of these losses, however, would be made up in job creation in other activities, including in sectors in which exports are significant. I do not wish to minimize the potential loss of 135,000 jobs, but this must be put in context of the U.S. economy as a whole, which has been adding more than two million jobs a year in recent years. The turnover of 135,000 jobs must be put in the context of the annual job turnover of eight million that now takes place in the U.S. economy.

There obviously are major educational and technical aspects to job creation and loss. The growing sectors generally demand higher skills and more investment per worker both in prior education and on the job. These points are well known and need little amplification in this brief statement. I wish there were some way to dedicate all the

resources that consumers must pay to protect jobs from foreign competition to improved education and job training. The amount could be as much as \$70 billion a year (based on an analysis by Gary Hufbauer and Kimberly Elliott for the year 1990). I realize that this is not a real-world solution – that there is no way to transfer resources from consumer losses to education and training budgets – but it is useful to keep in mind the magnitude of the cost of protection even as we do not provide enough resources for the real solutions to our problem of inequality, namely, better education and better training for U.S. workers.

Wages

There has been considerable debate among economists in recent years as to whether imports from low-wage countries force down wages of domestic workers in the same activities. The argument also is about how much of the growing wage gap in the United States between those with much education (at least through the college level) and those with little education (say, less than high school) is the result of imports from low-wage countries. Some respected economists believe that imports may explain as much as a quarter of the wage gap (Cline, Richardson, Leamer). The OECD concluded that these imports may explain as much as 10 percent of the wage gap. Others put the explanatory proportion of imports of the growing wage disparity much lower (Baldwin and Cain, Krugman, Lawrence and Slaughter). Whatever the percentage, no one argues that the wage gap would disappear if low-wage imports were completely cut off. We come back again to the main problem of training and education of our young people and our workers.

There is another side to the wage picture, namely, that workers in sectors where exports are important generally earn more than in non-export activities. The figure often given is that their earnings are about 12 to 13 percent higher. This follows logically from the previous discussion, that high export activities tend to require higher skills and employ persons with more education than those in the main import-competing activities. Some sort of balance must be drawn between the wage effects of imports and exports: if imports are repressed, thereby augmenting wages of the unskilled to some extent; and if the import protection leads to reduced exports, as most economists conclude is the case; then how does the nation as a whole come out? Badly, I think, because what we would then be doing is repress the competitive, encourage the noncompetitive, and expend rather than generate resources without getting at the basic problem.

Many of you know the story of what is happening with respect to real wages of salaried workers in the United States much better than I do. They were stagnant for many years, but have begun to increase in real terms more recently. The latest data from the Bureau of Labor Statistics is that the median weekly earnings of full-time wage and salary workers increased in the second quarter of 1999 by 5.4 percent over a year earlier, compared with an increase of 2.1 percent in the urban consumer price index. In line with the issue of education discussed earlier, for full-time workers, age 25 or more, with less than a high school diploma, median weekly earnings were \$345 during the second quarter

of 1999; for high school graduates with no college, \$489; and for college graduates, \$851. The figures go higher for persons with advanced degrees.

Summing up

I wish to highlight seven points:

1. It is not the trade *deficit* that affects U.S. workers, but rather the competition from imports.
2. Import restrictions can conserve jobs in noncompetitive activities, but the cost per job saved is extremely high.
3. These restrictions in an increasingly globalized world normally conserve jobs in noncompetitive activities at the expense of job creation in activities in which the U.S. is more proficient.
4. There is some effect on wage disparities in the United States from imports from low-wage countries, but we really do not know whether it is close to nil or whether these imports (combined with immigration of low-skilled workers) explain up to a quarter of the disparity.
5. What we do know, however, is that the main reason for the disparity in wages in the U.S. economy is the level of worker education. It is therefore here and in worker training where we must concentrate to reduce earning disparities in the United States.
6. Most important of all, it is impossible to assert in today's economy that the trade deficit is having an effect on the national level of unemployment. Imports do have an employment and wage effect, however, in some activities and in many localities.
7. In my judgment, this points to the need to retrain workers in import-affected activities who are unable to secure alternative employment on their own in the thriving U.S. economy; and for the long term, to dedicate more resources to education of our young people. This does not solve all the problems, but will not make the situation worse.

